Attachment D - Financial Information

See Attached

## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
T-NETIX, Inc.:

We have audited the accompanying consolidated balance sheets of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of T-NETIX, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with generally accepted accounting principles.

KPMG LLP

Denver, Colorado
March 21, 2000

## T-NETIX, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| **ASSETS** | | |
| Cash and cash equivalents | $ 118 | $ 678 |
| Accounts receivable, net (note 2) | 16,868 | 16,489 |
| Prepaid expenses | 1,038 | 1,023 |
| Inventories | 710 | 269 |
| Total current assets | 18,734 | 18,459 |
| Property and equipment, net (note 2) | 33,858 | 31,498 |
| Goodwill, net | 6,401 | 5,824 |
| Deferred tax asset | 2,297 | 962 |
| Intangible and other assets, net (note 2) | 9,252 | 8,736 |
| Total assets | $ 70,542 | $65,479 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Liabilities: | | |
| Accounts payable | $ 11,914 | $ 4,688 |
| Accrued liabilities (note 2) | 7,606 | 5,677 |
| Debt (note 5) | 7,366 | 21,353 |
| Total current liabilities | 26,886 | 31,718 |
| Long term debt (note 5) | 21,555 | 4,157 |
| Total liabilities | 48,441 | 35,875 |
| Stockholders' equity (note 6): | | |
| Preferred stock, $.01 stated value, 10,000,000 shares authorized; no shares issued | — | — |
| Common stock, $.01 stated value, 70,000,000 shares authorized; 12,699,400 and 12,225,634 shares issued and outstanding at December 31, 1999 and 1998, respectively | 127 | 122 |
| Additional paid-in capital | 35,791 | 33,052 |
| Accumulated deficit | (13,817) | (3,570) |
| Total stockholders' equity | 22,101 | 29,604 |
| Commitments and contingencies (note 9) | | |
| Total liabilities and stockholders' equity | $ 70,542 | $65,479 |

See accompanying notes to consolidated financial statements.

## T-NETIX, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (amounts in thousands, except per share amounts) | | |
| Revenue: | | | |
| Telecommunications services | $ 39,274 | $43,089 | $39,616 |
| Direct call provisioning | 27,517 | 22,736 | 19,051 |
| Equipment sales and other | 6,444 | 2,416 | 3,638 |
| Total revenue | 73,235 | 68,241 | 62,305 |
| Expenses: | | | |
| Operating costs and expenses: | | | |
| Telecommunications services | 17,674 | 17,014 | 15,262 |
| Direct call provisioning | 25,032 | 20,048 | 16,462 |
| Cost of equipment sold and other | 3,615 | 848 | 1,298 |
| Total operating costs and expenses | 46,321 | 37,910 | 33,022 |
| Selling, general and administrative | 13,794 | 13,401 | 11,816 |
| Research and development | 5,078 | 3,936 | 3,554 |
| Impairment of telecommunications assets | 4,632 | — | — |
| Depreciation and amortization | 11,620 | 10,174 | 9,546 |
| Total expenses | 81,445 | 65,421 | 57,938 |
| Operating income (loss) | (8,210) | 2,820 | 4,367 |
| Merger transaction expenses | (1,017) | — | — |
| Interest and other income (expense), net | (2,137) | (2,354) | (1,583) |
| Earnings (loss) before income taxes | (11,364) | 466 | 2,784 |
| Income tax benefit (expense) (note 8) | 1,117 | (196) | (1,039) |
| Net earnings (loss) | $(10,247) | $ 270 | $ 1,745 |
| Basic earnings(loss) per common share | $ (0.82) | $ 0.02 | $ 0.15 |
| Diluted earnings (loss) per common share | $ (0.82) | $ 0.02 | $ 0.13 |
| Weighted average common shares — basic | 12,511 | 12,172 | 11,909 |
| Weighted average common shares — diluted | 12,511 | 12,930 | 12,988 |

See accompanying notes to consolidated financial statements.

## T-NETIX, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders' Equity |
|---|---|---|---|---|---|
| | | | (amounts in thousands) | | |
| **Balances at January 1, 1997** | 11,505 | $ 115 | $ 30,130 | $ (3,279) | $ 26,966 |
| Common stock issued upon exercise of stock options | 155 | 2 | 204 | — | 206 |
| Common stock issued in business acquisition | 8 | — | 94 | — | 94 |
| Common stock issued for cash | 202 | 2 | 598 | — | 600 |
| Dividends paid to preferred stockholders | — | — | — | (36) | (36) |
| Tax benefit from stock options exercised (note 8) | — | — | 402 | — | 402 |
| Net earnings | — | — | — | 1,745 | 1,745 |
| **Balances at December 31, 1997** | 11,870 | 119 | 31,428 | (1,570) | 29,977 |
| Common stock issued upon exercise of stock options | 230 | 2 | 819 | — | 821 |
| Conversion of preferred stock | 149 | 1 | 592 | — | 593 |
| Purchase of treasury stock | (32) | — | (98) | (26) | (124) |
| Stock compensation | — | — | 75 | — | 75 |
| Dividends paid to preferred stockholders | — | — | — | (9) | (9) |
| Tax benefit from stock options exercised (note 8) | — | — | 198 | — | 198 |
| Adjustments to conform year ends of combined companies | 9 | — | 38 | (2,235) | (2,197) |
| Net earnings | — | — | — | 270 | 270 |
| **Balances at December 31, 1998** | 12,226 | 122 | 33,052 | (3,570) | 29,604 |
| Common stock issued upon exercise of stock options | 98 | 1 | 256 | — | 257 |
| Common stock issued for intangible asset (note 3) | 375 | 4 | 2,483 | — | 2,487 |
| Net loss | — | — | — | (10,247) | (10,247) |
| **Balances at December 31, 1999** | 12,699 | $ 127 | $ 35,791 | $(13,817) | $ 22,101 |

See accompanying notes to consolidated financial statements.

# T-NETIX, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (amounts in thousands) | | |
| Cash flows from operating activities: | | | |
| Net earnings (loss) | $(10,247) | $ 270 | $ 1,745 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization | 11,620 | 10,174 | 9,546 |
| Impairment loss and investment write-off | 4,632 | 600 | — |
| Deferred income tax expense (benefit) | (1,117) | 15 | 570 |
| Loss (gain) on sale of property and equipment | (206) | (83) | 6 |
| Stock compensation expense | — | 75 | — |
| Changes in operating assets and liabilities: | | | |
| Change in accounts receivable, net | (263) | 1,680 | (5,306) |
| Change in prepaid expenses | (48) | (678) | (146) |
| Change in inventory | (441) | (164) | 15 |
| Change in intangibles and other assets | (593) | (227) | (371) |
| Change in accounts payable | 6,972 | (549) | (4,834) |
| Change in accrued liabilities | 1,907 | (670) | 1,356 |
| Cash provided by operating activities | 12,216 | 10,443 | 2,581 |
| Cash used in investing activities: | | | |
| Capital expenditures | (14,560) | (6,190) | (9,061) |
| Acquisition of business or business assets | (1,377) | (2,679) | (175) |
| Proceeds from disposal or property and equipment | 473 | 121 | 13 |
| Other investing activities | (980) | (2,460) | (1,208) |
| Cash used in investing activities | (16,444) | (11,208) | (10,431) |
| Cash flows from financing activities: | | | |
| Net proceeds (payments) under line of credit | 11,489 | (2,318) | 6,765 |
| Payments of debt | (8,078) | (3,064) | (3,396) |
| Proceeds from debt | — | 5,731 | 3,722 |
| Common stock issued for cash under option plans | 257 | 821 | 206 |
| Common stock issued for cash | — | — | 600 |
| Treasury stock purchased | — | (124) | — |
| Dividends on preferred stock | — | (9) | (36) |
| Redemption on preferred stock | — | (7) | — |
| Cash provided by (used in ) financing activities | 3,668 | 1,030 | 7,861 |
| Net increase (decrease) in cash and cash equivalents | (560) | 265 | 11 |
| Adjustment to conform year ends of combined companies | — | 48 | — |
| Cash and cash equivalents at beginning of year | 678 | 365 | 354 |
| Cash and cash equivalents at end of year | $ 118 | $ 678 | $ 365 |
| Cash paid for interest | $ 2,568 | $ 1,773 | $ 1,502 |
| Cash paid for income taxes | $ 217 | $ 622 | $ 95 |

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
**December 31, 1999 and 1998**

## (1) Summary of Significant Accounting Policies

*General*

T-NETIX, Inc. and subsidiaries ("T-NETIX" or the "Company") was incorporated in Colorado in 1986. The Company has three reportable segments the Corrections Division, the Internet Services Division and the SpeakEZ Division ("SpeakEZ").

The Corrections Division primarily manages its specialized telecommunications hardware and software systems for long distance and local exchange carriers on a contractual basis. The long distance and local exchange carriers in turn pay a fee per call to the Company for each billable call made from a phone subject to a contract with the Company. The Company also receives revenue from billing collect calls made from correctional facilities in which the Company's specialized telecommunications hardware and software systems are located. The Internet Services Division provides interLATA Internet services to Internet subscribers and buys and resells Internet bandwidth. SpeakEZ engages in the research and development and sales and marketing of speaker verification technology.

*Basis of Presentation*

On June 14, 1999, the Company completed a merger with Gateway Technologies, Inc. ("Gateway"), a privately held provider of inmate calling services. As a result of the merger, Gateway became a wholly owned subsidiary of the Company. Prior to the merger, the Company changed its year-end from July 31 to December 31. Gateway's year-end was December 31.

The merger was accounted for as a pooling of interests. As a result, the Company's financial statements have been restated to combine Gateway's financial statements as if the merger had occurred at the beginning of the earliest period presented. Information concerning common stock and per share data has been restated on an equivalent share basis.

The consolidated statements of operations and cash flows for the years ended December 31, 1998 and 1997 have been recast to reflect the results of operations and cash flows for T-NETIX for the years ended July 31, 1998 and 1997, respectively, combined with Gateway for the years ended December 31, 1998 and 1997.

As a result of T-NETIX and Gateway having different fiscal year ends prior to 1999, the results of operations of T-NETIX for the five month period ended December 31, 1998, have been excluded from the reported results of operations. The net loss for the period and common stock transactions during that period have been accounted for as an adjustment of stockholders' equity at January 1, 1999. T-NETIX had revenue, expenses, and net loss of $15,041,000, $17,606,000, and $2,235,000, respectively, for the five month period ended December 31, 1998.

*Liquidity*

The Company incurred losses from continuing operations in the current year of $10.2 million and had a working capital deficit of $8.2 million at December 31, 1999. The Company received a waiver from its lenders relating to various covenant violations on its bank credit facility. In connection with the waiver, the lenders agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financing on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on the credit facility. These factors among others may indicate that the Company may not be able to meet its obligations as they become due or the Company may have to significantly reduce installations and curtail other operations.

**(1) Summary of Significant Accounting Policies (continued)**

The Company has taken steps to obtain the additional financing, on or before the deadline of April 14, 2000, by entering into term sheets to issue convertible preferred securities to a non-related party and subordinated debt instruments to one of the Company's directors. Management believes that they will complete the above financing arrangements in the time frame imposed by the lenders. Should the Company be unable to complete the financing arrangements or an alternative financing arrangement by the deadline currently imposed by the lenders, the Company would again be in breach of the loan agreement covenants and the lenders could commence immediate collection activity.

In addition, the Company is taking steps to increase cash flow from operations and obtain additional financing to ensure that the Company is able to carry out its fiscal 2000 business plan. There can be no assurance that the Company will be successful in increasing its cash flow from operations or that additional financing will be available, or if available, will be obtained on acceptable terms.

*Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Accounting Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

*Risks and Uncertainties*

A majority of the Company's revenue is generated from services provided to significant telecommunications customers. The loss of a major customer could affect operating results adversely.

*Cash Equivalents*

Cash equivalents consist of highly liquid investments, such as certificates of deposit and money market funds, with original maturities of 90 days or less.

*Fair Value of Financial Instruments*

The reported amounts of the Company's financial instruments including cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The reported amounts of debt approximate fair value due to market interest rates that these debts bear.

*Concentrations of Credit Risk*

Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's revenue is primarily concentrated in the United States in the telecommunications industry. The Company had trade accounts receivable from 5 customers that comprised 28% and 31% of total trade accounts receivable at December 31, 1999 and 1998, respectively. The Company does not require collateral on accounts receivable balances and provides allowances for potential credit losses. An allowance for doubtful accounts has been established based

**(1) Summary of Significant Accounting Policies (continued)**

on historical experience and management's evaluation of outstanding accounts receivable at the end of the accounting period.

*Inventories*

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values.

*Property and Equipment*

Property and equipment is stated at cost, including costs necessary to place such property and equipment in service. Major renewals and improvements are capitalized, while repairs and maintenance are charged to operations as incurred.

Construction in progress represents the cost of material purchases and construction costs, including interest capitalized during construction, for telecommunications hardware systems in various stages of completion. During the years ended December 31, 1999, 1998 and 1997, interest capitalized was insignificant.

Depreciation is computed on a straight-line basis using estimated useful lives of 3 to 7 years for telecommunications equipment and 5 to 10 years for office equipment. No depreciation is recorded on construction in progress until the asset is placed in service.

*Intangible and Other Assets*

Other assets include intellectual property assets, capitalized computer software, patent defense and application costs, deposits and long-term prepayments and other intangible assets. Patents and intangible assets are stated at cost. Amortization is computed on the straight-line basis over 17 years for patent costs and periods ranging from 3 to 7 years for other intangibles. Amortization charged to expense was $1,500,000, $936,000, and $796,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

*Goodwill*

Goodwill, representing the excess of the cost over the net tangible and identifiable assets of the acquired businesses, is stated at cost and is amortized, principally on a straight-line basis, over the estimated future periods to be benefited 5 to 10 years. On an annual basis, the Company reviews the recoverability of goodwill based primarily on an analysis of undiscounted cash flows from the acquired business. Accumulated amortization amounted to $1,103,000 and $364,000 at December 31, 1999 and 1998, respectively.

*Impairment of Long-Lived Assets*

The Company reviews its property and equipment and unamortized intangible assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company estimates the future cash flows expected to result from operations and if the sum of the expected undiscounted future cash flows is less than the carrying amount of the long-lived asset, the Company recognizes an impairment loss by reducing the unamortized cost of the long-lived asset to its estimated fair value.

During the year ended December 31, 1999, the Company recorded an impairment charge of telecommunications assets of $4,632,000. Impaired telecommunications assets consisted of software development costs, construction in progress, and inmate calling platform assets. Two events occurred in 1999 indicated that the carrying value of certain equipment and intangible assets may not be recoverable.

**(1) Summary of Significant Accounting Policies (continued)**

In September, 1999, the Company completed an evaluation of the future viability of its new inmate calling platform ("DL Platform") which it had been developing over the past two years. The merger with Gateway allowed the Company to consider an alternative to the DL Platform. The Company determined that the Gateway ComBridge Platform ("ComBridge"), would be the platform to install for both new customers and upgrades of existing customers. However, over the last year the Company had been awarded certain contracts where the DL Platform was to be deployed. Since the Company believes that it would not be cost effective to maintain and support two separate systems, the Company proceeded to renegotiate all existing contracts to install ComBridge instead of the DL Platform. During the quarter ended September 30, 1999, the Company successfully completed these negotiations. Due to the abandonment of the DL Platform, the Company no longer has any anticipated cash flow to support the carrying value of assets related to the DL Platform. Capitalized costs relating to the DL Platform included software development costs, components (consisting of primarily telephony cards) and other supporting computer peripheral equipment. The estimated impairment, being the excess of the carrying amounts over the respective estimated fair value of these assets, is approximately $3,669,000 for the year ended December 31, 1999. As a result, software development costs at December 31, 1999 were impaired by $2,093,000 and construction in progress relating to these products was impaired by $1,576,000. All of these charges are applicable to the Corrections Division.

In addition, the Company deployed a version of its old inmate calling platform that resides in its customer's network locations. The Company has recently experienced a reduction in call volumes and revenues for this platform. The customer has indicated to the Company that it does not intend to use the platform as a source of future services. Additionally, since the platform was based on the predecessor to the DL Platform, there is not an upgrade path available for the new platform. Any new feature or service offering would be evaluated based on the new ComBridge Platform. The reduction in call volumes caused the estimated fair value of these assets to be less than the existing book value. The Company estimated the fair value of these assets based on the discounted cash flows from each service location. After consideration of minimal salvage value of these assets due to their specific use, the Company recorded an impairment charge of approximately $963,000. This charge was applicable to the Corrections Division.

*Revenue Recognition*

Revenue and expenses from telecommunications services and direct call provisioning are recognized at the time the telephone call is completed. Provision is made for uncollectible accounts in the period direct call provisioning revenue is recorded. Revenue from equipment sales is recognized when the equipment is shipped to customers. Internet services are recognized as the services are provided. The Company records deferred revenue for advance billings to customers, or prepayments by customers prior to the completion of installation or prior to the provision of contractual bandwidth usage.

The Company recognizes revenue from the sale of computer software in accordance with the American Institute of Certified Public Accountants ("AICPA"), Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by Statement of Position 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2" ("SOP 98-4").

SOP 97-2 and SOP 98-4 generally require revenue earned on software arrangements involving multiple elements (i.e. software products, upgrades/enhancements, post contract customers support, installation, training , etc.) to be allocated to each element based on the relative fair value of the elements. The fair value of an element must be recognized upon delivery of the products. The revenue allocated to post contract customer support generally is recognized ratably over the term of the support and the revenue allocated to service elements (such as training and installation) generally is recognized as the services are performed. If a vendor does not have evidence of the fair value of all elements in a multiple-element arrangement, all revenue from the arrangement is deferred until such evidence exists or until all elements are delivered.

**(1) Summary of Significant Accounting Policies (continued)**

In December 1998, the AICPA issued Statement of Position 98-9, "Modification of 97-2, Software Revenue Recognition, With Respect to Certain Transactions" ("SOP 98-9"). SOP 98-9 requires the use of the "residual method" for recognition of revenue when vendor-specific objective evidence exists for undelivered elements but does not exist for delivered elements of a software arrangement. The Company will be required to comply with the provisions of SOP 98-9 for transactions entered into beginning January 1, 2000. The Company believes the adoption of SOP 98-9 will not have a material effect on its consolidated financial statements, results of operations or financial condition.

*Research and Development*

Costs associated with the research and development of new technology or significantly altering existing technology are charged to operations as incurred. Software development costs have been accounted for in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed.* Under the standard, capitalization of software development costs begins upon the establishment of technological feasibility, subject to net realizable value considerations. Capitalized software costs are amortized over the economic useful life of the software product, which is generally estimated to be three years.

The American Institute of Certified Public Accountants ("AICPA") Statement of Position 98-1, "Accounting for the Costs of Computer Software Development or Obtained for Internal Use ("SOP 98-1") provides guidance for the accounting for computer software developed or obtained for internal use including the requirement to capitalize specified costs. There were no such costs capitalized pursuant to SOP 98-1 at December 31, 1999 and 1998.

*401(k) Plan*

The Company established a 401(k) plan for all of its full time employees effective January 1, 1994. In June 1998, the Company implemented a matching program. The program calls for the Company to match 25% of an employee's contribution up to 6% of the individual employee's total salary. Matching contributions and plan expenses were $111,000 for the year ended December 31, 1999 and were not significant for the year ended December 31, 1998.

*Income Taxes*

The Company utilizes the asset and liability method of accounting for income taxes. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the results of operations in the period that includes the enactment date.

*Earnings (Loss) Per Common Share*

Earnings (loss) per common share are presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, *Earnings Per Share* (SFAS 128). Basic earnings per share excludes dilution for common stock equivalents and is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the year ended December 31, 1999,

**(1) Summary of Significant Accounting Policies (continued)**

375,000 common stock equivalents were not included in the diluted earnings per share calculation, as their effect would be anti-dilutive. For the years ended December 31, 1998 and 1997 diluted common and common equivalent shares outstanding includes 758,000 and 1,080,000, respectively of common share equivalents, consisting of stock options, determined under the treasury stock method.

*Stock Compensation*

The Company accounts for employee stock options under the provisions APB Opinion No. 25, *"Accounting for Stock Issued to Employees"* ("APB 25") and has adopted the "disclosure only" alternative described in Statement of Financial Accounting Standards No. 123, *"Accounting for the Stock-Based Compensation"* ("SFAS 123"), which requires pro forma disclosure of compensation expense using a fair value based method of accounting for stock-based compensation plans.

*Comprehensive Income*

Statement of Financial Accounting Standards 130, *"Reporting Comprehensive Income,"* (SFAS 130) establishes standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with stockholders ("comprehensive income"). Comprehensive income is the total of the net income (loss) and all other non-owner changes in equity. For the year ended December 31, 1999, 1998 and 1997, the Company's comprehensive earnings (loss) was equal to net earnings (loss).

*Recently Issued Accounting Pronouncement*

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. The statement requires companies to recognize all derivatives as either assets or liabilities, with the instruments measured at fair value. The accounting for changes in fair value, gains or losses, depends on the intended use of the derivative and its resulting designation. In June, 1999, the Financial Accounting Standards Board issued SFAS 137, "Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB No. 133 — An amendment of FASB Statement No. 133." SFAS 137 defers the effective date of SFAS 133 to all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company does not expect the adoption of SFAS 133 to have a material impact on its financial position or results of operations.

*Reclassification*

Certain amounts in the 1998 and 1997 financial statements have been reclassified to conform to the 1999 presentation.

## (2) Balance Sheet Components

Accounts receivable consist of the following:

| | December 31, | |
|---|---|---|
| | 1999 | 1998 |
| | (amounts in thousands) | |
| Accounts receivable, net: | | |
| Trade accounts receivable | $ 11,797 | $ 10,963 |
| Direct call provisioning receivable | 7,268 | 6,190 |
| Customer reimbursable receivable | 1,161 | 785 |
| Other receivables | 231 | 547 |
| | 20,457 | 18,485 |
| Less: Allowance for doubtful accounts | (3,589) | (1,996) |
| | $ 16,868 | $ 16,489 |

Bad debt expense was $4,981,000, $4,930,000, and $3,785,000 for the years ended December 31, 1999, 1998 and 1997, respectively.

*Property and equipment consist of the following:*

| | December 31, | |
|---|---|---|
| | 1999 | 1998 |
| | (amounts in thousands) | |
| Property and equipment, net: | | |
| Telecommunications equipment | $ 55,487 | $ 52,075 |
| Construction in progress | 7,341 | 5,011 |
| Office equipment | 9,169 | 7,326 |
| | 71,997 | 64,412 |
| Less: Accumulated depreciation and amortization | (38,139) | (32,914) |
| | $ 33,858 | $ 31,498 |

Intangible and other assets consist of the following:

| | December 31, | |
|---|---|---|
| | 1999 | 1998 |
| | (amounts in thousands) | |
| Intangible and other assets, net: | | |
| Patent license rights | $ 3,325 | $ 3,325 |
| Purchased technology assets | 2,487 | — |
| Capitalized software development costs | 651 | 1,821 |
| Acquired software technologies | 1,783 | 1,726 |
| Patent defense and application costs | 2,583 | 2,525 |
| Deposits and long-term prepayments | 1,183 | 505 |
| Other | 1,649 | 1,793 |
| | 13,661 | 11,695 |
| Less: Accumulated amortization | (4,409) | (2,959) |
| | $ 9,252 | $ 8,736 |

**(2) Balance Sheet Components — (continued)**

Accrued liabilities consist of the following:

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Accrued liabilities: | | |
| Deferred revenue and customer advances | $ 2,114 | $ 1,228 |
| Compensation related | 1,175 | 1,292 |
| Other | 4,317 | 3,157 |
| | $ 7,606 | $ 5,677 |

**(3) Mergers and Acquisitions**

*Gateway*

On June 14, 1999, the Company completed a merger with Gateway, by exchanging 3,672,234 shares of its common stock for all of the common stock of Gateway. Each share of Gateway was exchanged for 5.0375 shares of T-NETIX common stock. Outstanding Gateway stock options were also converted at the same exchange factor into options to purchase approximately 379,000 shares of T-NETIX common stock.

In addition, in connection with the merger transaction, T-NETIX issued 375,341 shares of common stock to certain shareholders of Gateway in exchange for terminating a royalty agreement. The royalty agreement related to automated call processing technology and intellectual property rights that were assigned to Gateway by the royalty owners in exchange for royalty payments. The termination of the royalty owners' interests resulted in the acquisition of an intangible asset. The asset has been recorded at fair value, or $2,487,000. The fair value is based on the value of T-NETIX common stock at February 10, 1999 (date of the Merger Agreement), or $6.625, times the number of shares issued in exchange for termination of the royalty owners' interests. The intangible asset has been recorded in patent license rights and has an estimated useful life of 10 years, the remaining term of the underlying patent.

Selected financial data of T-NETIX and Gateway, prior to the merger were as follows:

| | Three Months Ended March 31, 1999 | Years Ended December 31, 1998 | Years Ended December 31, 1997 |
|---|---|---|---|
| | (amounts in thousands) | | |
| Revenue: | | | |
| T-NETIX | $ 8,669 | $ 38,008 | $ 36,292 |
| Gateway | 9,115 | 30,233 | 26,013 |
| Combined | $ 17,784 | $ 68,241 | $ 62,305 |
| Net earnings (loss): | | | |
| T-NETIX | $ (1,077) | $ 394 | $ 591 |
| Gateway | 245 | (124) | 1,154 |
| Combined | $ (832) | $ 270 | $ 1,745 |

Transactions between T-NETIX and Gateway prior to the merger consisted of revenue from a cross-licensing agreement. All such amounts have been eliminated in the restated consolidated financial statements. There were no material adjustments required to conform the accounting policies of the two companies.

**(3) Mergers and Acquisitions — (continued)**

Certain reclassifications were made to the Gateway financial statements to conform to T-NETIX's presentations.

In connection with the merger, the Company incurred merger transaction expenses of $1,017,000 for the year ended December 31, 1999. Merger transaction expenses consisted primarily of fees for investment bankers, attorneys, accountants, financial printing and other related charges.

*Evans and Ricker Acquisition*

Effective October 28, 1999, the Company completed the acquisition of substantially all of the assets of Evans and Ricker ("E&R"), of Portland, Oregon. E&R specialize in software used to control and manage information for correctional facilities. E&R's product, Lock and Track Corrections Information System ("Lock & Track™") is a comprehensive relational database designed to handle the operational control and reporting needs of municipal, state, federal, and/or private correctional facilities. The purchase price was approximately $1.4 million including acquisition costs. The acquisition has been accounted for using the purchase method of accounting. The results of operations associated with the assets acquired are included in the Company's financial statements beginning November 1, 1999. Assets acquired and liabilities assumed have been recorded at their fair values. The assets acquired were cash, accounts receivable and intangibles. The estimated excess of cost over the estimated fair value of the net assets acquired of approximately $1.3 million was allocated principally to goodwill, which will be amortized on a straight line basis over 7 years. The remaining net assets acquired were primarily current assets (cash and accounts receivable) net of current liabilities (accounts payable and accrued liabilities). The acquisition was funded by borrowings under the Company's line of credit. Pro forma information giving effect to this acquisition has been omitted as the pro forma results do not vary materially from the Company's recorded results, as E&R's operations were not significant in 1998 or 1997.

**(4) SpeakEZ Operations**

In December 1998, the Company began an evaluation of the SpeakEZ Division and determined that the best course of action was to combine its research and development operations previously located in New Jersey with its corporate operations in Englewood, Colorado. This change coincided with the resignation of the Company's former chief executive officer on December 9, 1998. This individual spent a majority of his time in the SpeakEZ Division. For the five months ended December 31, 1998, the Company charged the cost of the severance agreement or approximately $240,000 to SpeakEZ selling, general and administrative expense.

The Company completed the reorganization of SpeakEZ operations in February 1999. The reorganization also included a change in the marketing strategy from a direct customer sales strategy to a technology licensing strategy. A direct customer sales strategy markets a specifically developed software product to a specific, end user customer. The strategy is then to find other specific customers who have similar operating systems and market this product to them. In contrast, a technology licensing strategy focuses on a larger scale customer who can integrate the SpeakEZ software product into its existing product line. This larger customer, such as a computer manufacturer, is then responsible for the product integration and ultimate delivery to the end user customer.

The change in marketing approach noted above required the Company to evaluate future marketability of all products in the SpeakEZ Division. As a result of this evaluation, management, determined that the capitalized cost for SpeakEZ products, some of which would no longer be marketed, exceeded their estimated realizable value. For the five months ended December 31, 1998, the Company incurred a charge of $490,000 for a reduction in the carrying value of such capitalized costs to their estimated net realizable value.

### (4) SpeakEZ Operations (continued)

The Company also recognized a loss in the SpeakEZ Division on a note receivable made to a venture partner for $300,000. In December 1998, the venture partner notified the Company that its plans to raise capital prior to January 1999 were not progressing according to plan and as a result it would not be able to meet its obligations as they became due.

### (5) Debt

Debt at December 31, 1999 and 1998 is summarized as follows:

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Debt: | | |
| Bank lines of credit | $ 28,461 | $ 16,972 |
| Advances on direct call processing | — | 2,531 |
| Notes payable to stockholders | — | 4,800 |
| Notes payable to banks | — | 625 |
| Other | 460 | 582 |
| | 28,921 | 25,510 |
| Less current portion | 7,366 | 21,353 |
| Non current portion | $ 21,555 | $ 4,157 |

In September 1999, the Company entered into a Senior Secured Revolving Credit Facility (the "Credit Facility") with its commercial bank. The Credit Facility provides for maximum credit of $40,000,000 subject to limitations based on financial covenant calculations. The Credit Facility is comprised of a one year LIBOR component of $15,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; a three month LIBOR component of $10,000,000 at an interest rate of LIBOR plus 2.75% at December 31, 1999; and $3,461,000 at the Bank's prime rate, 8.5% at December 31, 1999. As of December 31, 1999, the interest rate on borrowings under the line of credit ranged from 8.50% to 8.87%. The Company also pays a fee of 0.30% per annum on the unused portion of the line of credit.

The Credit Facility is collateralized by substantially all of the assets of the Company. Under the terms of the Credit Facility, the Company is required to maintain certain financial ratios and other financial covenants. These ratios include a debt to a four quarter rolling earnings before interest, taxes and depreciation and amortization (EBITDA) ratio, a ratio of fixed charges (interest and debt payments) to EBITDA, and minimum quarterly EBITDA. The Agreement also prohibits the Company from incurring additional indebtedness.

At December 31, 1999 the Company was in violation of certain covenants and the Company has received a waiver from its lenders relating to various covenant violations. In connection with the waiver, the lenders agreed to revise the existing covenant requirements if the Company can raise $7 million of additional financing on or before April 14, 2000. The funds raised are required to be used to reduce the outstanding balance on the Credit Facility. The terms of the bank dictate that $7 million of the Credit Facility is due April 14, 2000 with the remaining balance of the facility due April 30, 2001. The amount of credit under the Credit facility available to the Company is dependent upon our financial performance and may be less than $40 million.

## (6) Stockholders' Equity

*Stock Option Plans*

The Company has reserved 3,850,000 shares of common stock for employees and non-employee directors under various stock option plans (collectively the "Plans"): the 1991 Incentive Stock Option Plan ("the 1991 ISO Plan"); the 1991 Non-Qualified Stock Option Plan ("the 1991 NSO Plan"); and the 1993 Incentive Stock Option Plan ("the 1993 ISO Plan"). The Plans provide for issuing both incentive stock options, and non-qualified stock options, which must be granted at not less than 100% of the fair market value of the stock on the date of grant. All options to date have been granted at the fair market value of the stock as determined by the Board of Directors. Options issued prior to 1994 had vesting terms of one to three years from the date of grant. Substantially all of the Incentive Stock Options issued after 1993 vest over four years from the date of grant. The options expire ten years from the date of grant.

A summary of the Company's stock option activity, and related information through December 31, 1999 is as follows:

| | | Options Outstanding | |
|---|---|---|---|
| | Shares Available for Grant | Number of Shares | Weighted Average Exercise Price |
| Balance at January 1, 1997 | 476,163 | 2,513,957 | $ 4.55 |
| Granted | (111,500) | 111,500 | $ 8.61 |
| Exercised | — | (281,200) | $ 2.67 |
| Canceled | 96,875 | (96,875) | $ 6.83 |
| Balance at December 31, 1997 | 461,538 | 2,247,382 | $ 4.88 |
| Granted | (246,619) | 246,619 | $ 5.24 |
| Exercised | — | (77,477) | $ 2.86 |
| Canceled | 166,000 | (166,000) | $ 6.45 |
| Balance at December 31, 1998 | 380,919 | 2,250,524 | $ 4.88 |
| Granted | (223,800) | 223,800 | $ 5.34 |
| Exercised | — | (98,425) | $ 2.61 |
| Canceled | 456,769 | (456,769) | $ 6.92 |
| Balance at December 31, 1999 | 613,888 | 1,919,130 | $ 4.56 |

The range of exercise prices for common stock options outstanding and options exercisable at December 31, 1999 is as follows:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price | Number of Shares | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| $ 0.20 | 281,475 | 1.3 years | $ 0.20 | 281,475 | $ 0.20 |
| $ 1.61 | 307,490 | 6.7 years | $ 1.61 | 307,490 | $ 1.61 |
| $ 3.00-$4.11 | 154,090 | 4.4 years | $ 3.32 | 136,590 | $ 3.25 |
| $ 4.12-$5.48 | 222,800 | 9.2 years | $ 5.08 | 30,000 | $ 5.04 |
| $ 5.49-$7.24 | 455,525 | 6.2 years | $ 5.58 | 369,025 | $ 5.50 |
| $ 7.25 | 394,750 | 6.1 years | $ 7.25 | 359,875 | $ 7.25 |
| $ 7.26-$10.99 | 53,000 | 7.9 years | $ 9.07 | 36,750 | $ 9.12 |
| $11.00-$13.71 | 50,000 | 6.0 years | $13.44 | 46,250 | $13.64 |
| $ 0.20-$13.71 | 1,919,130 | 5.8 years | $ 4.56 | 1,567,455 | $ 4.31 |

**(6) Stockholders' Equity (continued)**

The Company has not recorded compensation expense for stock options granted. The Company has computed the pro forma disclosures required under SFAS 123 for stock options granted using the Black-Scholes option-pricing model. The assumptions are as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Risk free interest rate | 5.43% | 5.24% | 5.24% |
| Expected dividend yield | — | — | — |
| Expected lives (in years) | 5.2 years | 5.0 years | 4.9 years |
| Expected volatility | 70.0% | 70.0% | 70.0% |
| Weighted average remaining contractual life of options outstanding | 5.8 years | 4.9 years | 5.2 years |
| Weighted average fair value at grant date | $3.24 | $2.35 | $4.11 |

The pro forma effects of applying SFAS 123 are as follows for the years ended December 31, 1999, 1998, and 1997:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (amount in thousands) | | |
| Net earnings (loss): | | | |
| As reported | $(10,247) | $ 270 | $1,745 |
| Pro forma | (11,118) | (847) | 620 |
| Net earnings (loss) per common share: | | | |
| As reported: | | | |
| Basic | $ (0.82) | $ 0.02 | $ 0.15 |
| Diluted | (0.82) | 0.02 | 0.13 |
| Pro forma: | | | |
| Basic | $ (0.89) | $(0.07) | $ 0.05 |
| Diluted | (0.89) | (0.07) | 0.05 |

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models to not necessarily provide a reliable single measure of the fair value of its employee stock options.

In July, 1997, the Board of Directors amended the 1993 ISO Plan and the 1991 NSO Plan to provide that the Compensation Committee may amend certain outstanding options with an exercise price in excess of the current market price in order to modify the exercise price to the current market price or greater. On August 11, 1997, the Compensation Committee re-priced the exercise price to $7.25 per share for certain outstanding options under the 1993 ISO Plan and the 1991 NSO Plan having an exercise price equal to or greater than $7.50 prior to such re-pricing. This re-pricing affected 773,500 options granted under these Plans.

**(7) Segment Information**

Statement of Financial Accounting Standards No. 131, Disclosures About Segments of an Enterprise and Related Information, ("SFAS 131") establishes standards for the way public enterprises report information about operating segments in annual financial statements. SFAS 131 also establishes standards for disclosures about products and services, geographic areas and major customers.

The Company has three reportable segments; the Corrections Divisions, the SpeakEZ Division, and Internet Services Division. The Company evaluates performance based on earnings (loss) before income taxes. Additional measures include operating income, depreciation and amortization, and interest expense. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Segment information is as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (amounts in thousands) | | |
| **Revenue from external customers:** | | | |
| Corrections Division | $ 71,596 | $ 67,609 | $ 61,629 |
| SpeakEZ Division | 93 | 632 | 676 |
| Internet Services Division | 1,546 | — | — |
| **Operating income (loss):** | | | |
| Corrections Division | $ (5,796) | $ 6,816 | $ 7,031 |
| SpeakEZ Division | (2,518) | (3,996) | (2,664) |
| Internet Services Division | 104 | — | — |
| **Depreciation and amortization** | | | |
| Corrections Division | $ 10,651 | $ 9,250 | $ 8,841 |
| SpeakEZ Division | 969 | 924 | 705 |
| Internet Services Division | — | — | — |
| **Interest and other income (expense)** | | | |
| Corrections Division | $ (1,217) | $ (1,762) | $ (1,216) |
| SpeakEZ Division | (920) | (592) | (367) |
| Internet Services Division | — | — | — |
| **Segment earnings (loss) before tax:** | | | |
| Corrections Division | $ (8,029) | $ 5,054 | $ 5,815 |
| SpeakEZ Division | (3,439) | (4,588) | (3,031) |
| Internet Services Division | 104 | — | — |
| **Segment earnings (loss) before tax:** | | | |
| Revenue from external customers | $ 73,235 | $ 68,241 | $ 62,305 |
| Operating income (loss) | (8,210) | 2,820 | 4,367 |
| Depreciation and amortization | 11,620 | 10,174 | 9,546 |
| Interest and other (income) expense, net | 2,137 | 2,354 | 1,583 |
| Segment earnings (loss) before tax | (11,364) | 466 | 2,784 |

**(7) Segment Information — (continued)**

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| | (amounts in thousands) | |
| **Segment assets:** | | |
| Corrections Division | $ 66,943 | $ 60,880 |
| SpeakEZ Division | 3,599 | 4,599 |
| Internet Services Division | — | — |

Substantially all of the Company's reportable segment revenue is derived within the United States. Revenue as a percentage of total revenue attributable to significant customers for the years ended December 31, 1999, 1998 and 1997 is as follows:

| | 1999 | 1998 | 1998 |
|---|---|---|---|
| AT&T | 13% | 16% | 19% |
| Bell Atlantic | 10 | 12 | 12 |
| SBC Communications | 10 | 12 | 13 |

There was no intersegment revenue for the years ended December 31, 1999, 1998 and 1997. Unallocated amounts to arrive at net earnings (loss) included income tax expense (benefit) of $(1,117,000), $196,000, and $1,039,000 for the years ended December 31, 1999, 1998 and 1997, respectively. Consolidated total assets included eliminations of approximately $12,976,000 and $11,084,000 as of December 31, 1999 and 1998, respectively. Eliminations consist of intercompany receivables in the Corrections Division and intercompany payables in the SpeakEZ Division related solely to intercompany borrowing of the SpeakEZ Division.

**(8) Income Taxes**

Income tax expense for the years ended December 31, 1999, 1998 and 1997 is as follows (amounts in thousands):

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Current: | | | |
| Federal | $ (1,007) | $ 186 | $ 439 |
| State | (191) | 25 | 30 |
| Total | (1,198) | 211 | 469 |
| Deferred: | | | |
| Federal | 72 | (55) | 516 |
| State | 9 | 40 | 54 |
| Total | 81 | (15) | 570 |
| Total income tax expense (benefit) | $ (1,117) | $ 196 | $ 1,039 |

**(8) Income Taxes (continued)**

Income taxes differ from the expected statutory income tax benefit, by applying the US federal income tax rate of 34% to pretax earnings for the years ended December 31, 1999, 1998 and 1997 due to the following:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Expected statutory income tax (benefit) expense | $ (3,864) | $ 273 | $ 947 |
| Amounts not deductible for income tax | 699 | 107 | 97 |
| State taxes, net of federal benefit | (377) | 43 | 55 |
| Change in valuation allowance | 2,263 | (113) | — |
| Other | 162 | (114) | (60) |
| Total income tax expense (benefit) | $ (1,117) | $ 196 | $ 1,039 |

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities as of December 31, 1999 and 1998 are presented below:

| | 1999 | 1998 |
|---|---|---|
| | (amounts in thousands) | |
| Deferred income tax assets: | | |
| Net operating loss carryforwards | $ 6,556 | $ 5,406 |
| Allowance for doubtful accounts | 1,488 | 716 |
| Other | 680 | 458 |
| Total gross deferred income tax assets | 8,724 | 6,580 |
| Less valuation allowance | (3,727) | (1,464) |
| | 4,997 | 5,116 |
| Deferred income tax liabilities: | | |
| Intangible assets, due to difference in book/tax basis | (474) | (1,068) |
| Property and equipment, principally due to differences in depreciation | (1,867) | (2,523) |
| Other assets, due to differences in book/tax basis | (359) | (563) |
| Total gross deferred tax liabilities | (2,700) | (4,154) |
| | $ 2,297 | $ 962 |

At December 31, 1999, the Company had net operating loss carryforwards for tax purposes aggregating approximately $17.4 million which, if not utilized to reduce taxable income in future periods, expire at various dates through the year 2010. Approximately $1.3 million of the net operating loss carryforwards are subject to certain rules limiting their annual usage. The Company believes these annual limitations will not ultimately affect the Company's ability to use substantially all of its net operating loss carryforwards for income tax purposes.

A valuation allowance is provided when it is more likely than not that some portion or the entire net deferred tax asset will not be realized. The Company has offset a portion of its deferred tax assets with a valuation allowance. The valuation allowance will be adjusted in the future based on the Company's projected taxable income.

The exercise of stock options, which have been granted under the Company's 1991 NSO stock option plan gives rise to compensation which is included in the taxable income of the applicable option holder and is deductible by the Company for federal and state income tax purposes. The income tax benefit associated with the exercise of the NSO options is recorded as an adjustment to additional paid-in capital when realized.

**(9) Commitments and contingencies**

The Company leases office space under operating lease agreements. Rent expense under operating lease agreements for the years ended December 31, 1999, 1998 and 1997 was approximately $1,034,000, $930,000, and $629,000, respectively. Future minimum lease payments under these lease agreements for each of the next five years are summarized as follows (amounts in thousands):

| | |
|---|---|
| Year ending December 31: | |
| 2000 | $ 976 |
| 2001 | 721 |
| 2002 | 229 |
| 2003 | 5 |
| Total minimum lease payments | $1,931 |

The Company is involved in various legal proceedings of a nature considered normal to its business. It is the Company's policy to accrue amounts related to these legal matters if it is probable that a liability has been incurred an amount that is reasonable estimable. In the opinion of management, all matters are of such a nature as would not have a material affect on the Company's financial position, results of operations and cash flows of the Company if resolved unfavorably.